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No. 91-1120

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

Petitioners,

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

ROBERT W. GETTLEMAN
Counsel of Record
D'ANCONA & PFLAUM
30 N. LaSalle St., Suite 2900
Chicago, Illinois 60602
(312) 580-2000

EUGENE L. MAHONEY
EUGENE L. MAHONEY
& ASSOCIATES, P.C.
180 N. LaSalle St., Suite 1101
Chicago, Illinois 60601
(312) 346-5255

Attorneys for Petitioners

Of Counsel:

LAWRENCE G. GALLAGHER
D'ANCONA & PFLAUM
30 N. LaSalle St., Suite 2900
Chicago, Illinois 60602

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

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Introduction

Home Life's Brief in Opposition attempts to perpetuate the error of the court of appeals by ignoring the reason this litigation was brought and prosecuted: to examine, expose and redress self dealing with retirement assets by an insurance company and its associates. The court below ruled that the petitioners had no right to question Home Life's and the Bank's practices of imposing hidden and unauthorized charges in computing the "flexible" portion of the earnings of petitioners' retirement funds—an act of judicial legislation that exempts a risk-shifting investment contract from the securities laws and ERISA.

Should this court deny certiorari, the rest of the insurance industry will surely walk through the door opened by Home Life, the Bank and the Seventh Circuit—a door that leads to judicially created deregulation of a major portion of two areas that Congress has consistently sought to regulate: securities and retirement benefits.

A. The Flexibility Annuity Contract Is A Security.[1]

Home Life's brief in opposition attempts to minimize its corporate resolution (PLX 52; Appendix D to Petition), which reserves the right to alter interest rates at Home Life's discretion, by arguing that in 1980 Home Life did not in fact "reconsider" the declared rates. (Brief in Opposition, p. 5.) Yet, Home Life has not contested the fact

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[1] Home Life's statement that petitioners do not seek review of the lower courts' findings regarding fraud and misrepresentation (Brief in Opposition, p. 11) is wrong. Petitioners seek review and reversal of the rulings that respondents are not subject to the anti-fraud provisions of the federal securities laws and ERISA's fiduciary rules.

that it unilaterally reserved the *right* to alter the declared rates on both *old and newly invested* money, based on its investment performance, thereby shifting the investment risk to petitioners and other holders of the Flexible Annuity. It is this shifting of risk that makes the Section 3(a)(8) exemption inapplicable to the Flexible Annuity and similar investment vehicles.

Because Home Life does not dispute that the parties stipulated as uncontested fact that Rhode Island had no statute regulating group annuities,[2] Home Life cannot argue that Rhode Island regulated the Flexible Annuity, a fallacious finding by the court below. Indeed, Home Life chose Rhode Island for its group trust with the Bank because of the absence of regulation in that state—a state which has seen its financial institutions ravaged by its lack of regulation.[3]

B. General Account Insurance Contracts Do Not Enjoy Legislative Or Administrative Exemption From ERISA's Fiduciary Rules.

Contrary to respondent Home Life's assertions, the insurance industry has always understood that ERISA, as interpreted by the U.S. Department of Labor ("DOL"), did not exempt all general account assets from fiduciary status.[4] Beginning in 1976 and continuing through the

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[2] Uncontested Fact Nos. 162, 170, 171.

[3] *See*, "Rhode Island Governor Closes 45 Institutions," *Wall Street Journal*, January 2, 1991, Section A, Page 2.

[4] For a complete analysis of the insurance industry's legislative and administrative attempts to exempt itself from ERISA fiduciary duties, *see* Kill, *Statutory History Points Toward Coverage of Insurer's Account*, Nat'l L.J., Nov. 5, 1990, at 32-33. The following paragraphs draw from the material in that article.

1980's, the American Council of Life Insurance (ACLI), the insurance industry's trade group and lobbyist, began lobbying Congress, unsuccessfully, to unambiguously relieve insurance companies issuing contracts from their general accounts from ERISA's fiduciary duties. ACLI then made a serious and concerted effort to obtain DOL approval of, or at least non-opposition to, its position. In 1984 and 1985, DOL declined to support ACLI's legislative proposals. In essence, DOL believed that pension funds in insurers' general accounts, under certain circumstances (e.g., where, as in the instant case, the customer participates in the investment experience of the insurer), required federal regulation of the insurance companies.

DOL also objected to ACLI's efforts to exempt *all* general account group annuity contracts entered into before the 1984-1985 legislative proposals' effective date, and to characterize contracts which merely provide a guarantee of principal as "guaranteed" and thus exempt from ERISA's fiduciary requirements. Thereafter, in late 1985, ACLI attempted to codify DOL Interpretive Bulletin 75-2, dealing with prohibited transactions, through an amendment to the Budget Reconciliation Bill of 1985.[5] Again, the effort failed. DOL's continuing resistance led ACLI to abandon its legislative proposals and instead to work for an acceptable "safe harbor" in DOL's regulations on plan assets. This effort also failed.[6]

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[5] Home Life misrepresents DOL Interpretive Bulletin 75-2 as a blanket exemption from ERISA's fiduciary duties, rather than a limited exemption from ERISA's prohibited transaction rules to which the Bulletin applies. In its final 1986 plan asset regulation, DOL made clear its intent that IB 75-2, as amended, applies only to DOL's interpretation of ERISA's prohibited transaction rules. 51 Fed. Reg. 41262, 41278 (No. 219 Nov. 13, 1986).

[6] *See* fn. 4, *supra*.

Unless this Court reverses the decision of the lower court in this case, the insurance industry will have achieved by judicial fiat an exemption from ERISA's fiduciary duties that ACLI could not accomplish in more than fifteen years of concerted legislative and administrative lobbying.

C. Home Life And The Bank Violated Their Fiduciary Duties Under ERISA.

By seeking to preserve the court of appeals' decision, Home Life arrogates to itself the concurrent powers to: (i) market its investment expertise to ERISA plans; (ii) avoid ERISA fiduciary responsibility for making investment decisions by characterizing its products as general account policies; (iii) affect ERISA plans' returns by unilaterally charging undisclosed and unauthorized expenses and fees; (iv) shift investment risk to ERISA plans; and (v) enjoy, by means of judicial conflict, a freedom from regulatory accountability that the insurance industry has repeatedly failed to obtain through legislative initiative.

Home Life's Brief in Opposition seeks to distract the Court's attention from, (a) Home Life's claimed power to adjust investment returns, and (b) its exercised power to reduce investment returns through unilaterally determined and undisclosed fees and charges. It does so by making the irrelevant suggestion that it did not exercise the former power and by ignoring its exercise of the latter power. Home Life's brief compounds this distraction by a lengthy discourse on the alleged consistency between inconsistent holdings of the Third and Seventh Circuits on the definition of a guaranteed benefit contract. The decision in this case, unlike the correct decision in *Mack Boring*,[7] ignores

[7] *Mack Boring & Parts Co. v. Meeker Sharkey Moffit*, 930 F.2d 267 (3d Cir. 1991).

the fact that ERISA shields insurers from pension regulation only "to the extent" that they guarantee retirement benefits to plan participants.[8] The insurance industry's legislative and administrative efforts attempted unsuccessfully to eliminate the above-quoted language, which the Seventh Circuit's opinion has effectively and literally excised from its reading of ERISA. (App. A, pp. 11-12.)

Thus, respondents cannot escape the conclusion that "to the extent" the Flexible Annuity did not guarantee a retirement plan's benefits—i.e., the "flexible" portion of the return that depended upon the performance of Home Life's investments and the manner in which it handled those investments—it is not exempt from ERISA's fiduciary duties. Yet, the court of appeals erroneously exempted this portion of the return on the Flexible Annuity that Home Life and the Bank manipulated by self-dealing.

D. The Issues Presented Are Important Enough to Justify Granting the Writ.

Home Life's Flexible Annuity and similar products are not "traditional annuity contracts." (Brief in Opposition, p. 11.) They are risk-shifting investment vehicles that their managers should regard with the same respect due other retirement assets. To exempt these instruments completely from securities *and* ERISA regulation puts the 62 million Americans' $713 billion in retirement assets invested with insurance companies[9] at grave risk. This issue is especially urgent because the insurance industry itself faces unprecedented solvency problems.[10]

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[8] ERISA § 401(b)(2)(B), 29 U.S.C. § 1102(b)(2)(B).

[9] *See*, Petition, fn. 6, p. 7.

[10] *See*, "Life Insurer's Loans On Real Estate Cause Ever-Rising Worries," *Wall Street Journal*, January 31, 1992, Section A, p. 1.

The court of appeals in this case substituted a judicially crafted, rather than the congressionally mandated, standard for exemption from ERISA fiduciary rules. The holding in this case substitutes the *timing* of the exercise of Home Life's power to determine and declare the Flexible Annuity's excess rate (i.e., at the beginning versus the end of the year) rather than *the extent to which* such power insures the payment of the promised deferred compensation (i.e., whether Home Life guarantees *less than all* the retirees' pension benefits). Because the decision in this case has the startling result of shielding discretionary, risk-shifting conduct from scrutiny under both the securities laws and ERISA without a showing of state regulation, petitioners urge this Court to grant the writ of certiorari and reverse the ruling below.

Respectfully submitted,

ROBERT W. GETTLEMAN
Counsel of Record
D'ANCONA & PFLAUM
30 N. LaSalle St., Suite 2900
Chicago, Illinois 60602
(312) 580-2000

EUGENE L. MAHONEY
EUGENE L. MAHONEY
& ASSOCIATES, P.C.
180 N. LaSalle St., Suite 1101
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(312) 346-5255

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